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Central Intelligence Agency



Washington, D. C. 20505

Executive Registry

85- 595

5 February 1985

25X1 [redacted]
Advance Concepts Staff
Office of Research and Development

25X1 Dear [redacted]

I am sorry to be so long in responding to your 19 December 1984 suggestions, but along with the usual interruptions brought about by the holidays your suggestions required a bit of homework. Without violating the usual need-to-know principles, it can be said that we do within the CIA, from time to time, carry out the kind of operations you have proposed for the sensible reasons you suggest. In general, though, it has been our judgment that a standing unit devoted to this task would add relatively little to what we achieve from the periodic ad hoc effort. I have, nevertheless, asked the DDA to consider again the value of such a program.

Similar activities have also been mounted in other parts of the Intelligence Community. It is our view that these kinds of programs are best mounted under the command auspices of the responsible Department or Agency, in this case the Department of Defense. I foresee numerous practical, and possibly legal, difficulties were we to take on this responsibility for other organizations. I am sure that you are also aware that both the Department of Defense and the Department of Energy carry on fairly extensive operational security programs for their various physical facilities.

Again, our apologies for the delay. The DCI joins me in expressing appreciation to you for taking the time to set down your ideas. I have also passed on your other ideas for further consideration.

25X1 Sincerely,

[redacted]
Executive Director

DCI
EXEC
REG

CONFIDENTIAL

0-102

Central Intelligence Agency
Washington, D.C. 20505

17 January 1985

Executive Director

Executive Registry
85- 314

NOTE FOR: [redacted]

C/CCIS

FROM: EA/ExDir

As you probably know, the DCI has asked for creative suggestions for solving problems. Attached is a memo proposing that the DCI establish a group which would attempt

[redacted] Your comments would be helpful for the Executive Director's use in preparation of a response to this suggestion.

Attachments

cy of suggestion (ORD 1379-84)
cy of dcie memo re CPS

ER -
~~orig handcarried~~
per note



QR

S E C R E T

ROUTING AND RECORD SHEET

SUBJECT: (Optional)

Creative Problem Solving

FROM:

506 Ames Bldg.
ACS/ORD

EXTENSION

NO.

ORD 84-1379

DATE

19 December 1984

TO: (Officer designation, room number, and building)

DATE

OFFICER'S INITIALS

COMMENTS (Number each comment to show from whom to whom. Draw a line across column after each comment.)

RECEIVED

FORWARDED

1. DCI
7-E-12 Headquarters

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James S. C.

Defense Spending: How About Some Real Competition?

The Pentagon should get "more bang for the buck"; and most agree that "more competition" is a good way to do it. However, there is a right and a wrong form of competition; and the Defense Department uses the wrong one.

The argument runs like this: the president and Congress decide to increase the quantities of the XYZ missile. But, as with almost all defense products, only one company currently builds this missile. It would take time and money to set up another firm, so the government simply increases its order from the existing source. This firm will accept the order, but it will explain why prices must go up (inflation, skilled labor shortages, insufficient parts suppliers, technical changes to the missile, higher costs of materials, increased employee benefits programs, etc.) Simultaneously, it will extend delivery times—the firm would rather build up its order backlog than go out and spend extra money for new production machines.

As demand increases, supply should expand and prices fall. But such economic theory only applies in the civilian world, where competition exists. In the defense world, with only one supplier, the government is forced to "negotiate" and attempt to "regulate" that supplier. The answer seems obvious: the Defense Department should create alternate production sources, thus allowing competition to drive down prices and improve product quality.

Interestingly, when this "dual-sourcing" approach was tried in the past, the average cost of

the military goods procured was approximately 30 percent less, and the reliability of the systems significantly improved. Such cases clearly demonstrate that the benefits of continuous competition more than justify the added costs of setting up a second source and the production of fewer units in each of the two factories.

In recent years, the only Navy fighting ships that were multiple-sourced, the Patrol Frigates (FFG)—built in Bath, Maine; San Pedro, Calif.; and Seattle, Wash.—proved the point again. Still more dramatic savings and quality improvements have occurred on larger-quantity, dual-source procurements of sophisticated munitions, electronics equipment and full missile systems.

Even with the increased attention being paid by Congress and the executive branch to "ineffective government procurement practices" and to "the deteriorating defense industrial base," the same sole-source procurement practices continue. For example: after an extremely successful, dual-source development of the cruise missile, the government awarded sole-source contracts to Boeing to build the air-launched version (for the Air Force), and to General Dynamics to build the ground-launched version (for the Army) and the ship-launched version (for the Navy). Independent studies indicated the potential for hundreds of millions—if not billions—of dollars of net savings if both firms had been awarded contracts to produce all three versions.

Instead, a winner-take-all "auction" for the award of the air-launched version was held.

This one-time competition is referred to in the industry as "you bet your company." Each firm is required to bid unrealistically low ("buy-in"), since the whole issue is winning. Only large, multi-billion dollar firms can afford to play this game. History has shown that such an "auction" leads inevitably to future program "cost growths." The winner—once he is the only supplier—begins to encourage technical or program changes (usually thousands of these changes occur annually on a large military procurement), thus allowing him to price these changes on a noncompetitive basis and thereby to recover his "buy-in" losses. It's called the "get well" program—for obvious reasons.

Unfortunately, this form of one-time-only competition is the normal mode of defense procurement. Interestingly, when defense officials testify about the amount of competition in defense procurements, they list programs originally awarded in this fashion in the "competitively awarded" category. The reality is that there once was a competition held for that product—years ago—but since then all orders have been placed only with the winning firm.

The critically important distinction is the difference between competition for an award with subsequent sole-source production, and competition during the life of the program through dual-sourcing. The latter is the civilian approach, while the former is the Defense Department form—and a principal cause of the inefficiencies, overruns and other prob-

lems that exist in defense procurements today.

Yet, the rising cry of "more competition in defense procurements" is being met with more and more "auctions." Worse yet, since the large number of defense contracts are for small dollar amounts—that is, engineering analyses—the government holds auctions for these so the "scorecard" looks better—even though these competitions often cost more than they save.

In the 1982 budget cycle, Sen. Sam Nunn introduced a bill to require dual-sourcing on the Army's Infantry Fighting Vehicle, and proposed to add the necessary start-up money for the second source. But the current contractor, who has been the only supplier of this vehicle for over 20 years, successfully lobbied with the Army and Congress, and the program is likely to remain with that same supplier for another 20 years—in spite of the large price increase that have recently been reported.

There is no problem in identifying defense programs to which the dual-sourcing concept should be applied. However, the two problems—that takes a few more dollars on the "front end," and that "it's not the way the government has always done things"—are high barriers. They take courage and initiative to overcome. But the historic data are clear—costs go down and quality goes up when real competition is used.

The writer is a former deputy assistant secretary of defense.